

## How can cigarette smuggling be reduced?

Luk Joossens, Martin Raw

The tobacco industry has argued that tobacco smuggling is caused by market forces—by the price differences between countries, which create an incentive to smuggle cigarettes from “cheaper” countries to “more expensive” ones. The industry has urged governments to solve the problem by reducing taxes, which will also, it says, restore revenue. The facts contradict all these assertions. Smuggling is more prevalent in “cheaper” countries, and where taxes have been reduced, such as in Canada, consumption has risen and revenue fallen. There are, however, countries that have solved the problem by better control, Spain being the most impressive example to date, and the new World Health Organization framework convention may at last promote control of tobacco smuggling at the level at which it must be tackled—globally.

Tobacco smuggling has become a critical public health issue because it brings tobacco on to markets cheaply, making cigarettes more affordable and thus stimulating consumption, consequently increasing the burden of ill health caused by its use. Smuggling is not a small phenomenon: we have estimated that, globally, a third of legal cigarette exports disappear into the contraband market.<sup>1</sup> This extraordinary proportion results in a second key effect of smuggling—the loss of thousands of millions of dollars of revenue to government treasuries. We also showed in our earlier studies that tobacco smuggling defies apparent economic logic. Common sense might suggest that cigarettes would be smuggled from countries where they are cheap (southern Europe, for example) to expensive countries (such as northern Europe) and that this is due simply to price differences between these countries, as the tobacco industry claims. Although this does happen, it is not the largest type of smuggling, and in Europe there is far more smuggling from north to south rather than the reverse.<sup>2</sup>

In fact, smuggling occurs in all parts of the world, even in regions where taxes are low. One internal document of BAT (British American Tobacco), the largest European international tobacco company, estimated that 318 billion (nearly 6%) of world cigarette sales of 5300 billion were DNP (duty not paid) cigarettes, an industry term for contraband.<sup>3</sup> Eastern Europe and the Asia-Pacific region accounted for most of this, at about 85 billion each, although Western Europe was also important at about 50 billion. In relation to total market sales, volumes of DNP cigarettes are largest in Eastern Europe (about 13%) and in Africa and the Middle East (about 12%) but are also

### Summary points

Cigarette smuggling occurs in all parts of the world, even in regions where taxes and prices are low

The solution to combat smuggling is not to decrease taxes, as this will increase consumption and decrease revenue

Spain has been successful in combating smuggling by reducing the supply of illegal cigarettes

Only action to control cigarette transit at international level will solve the smuggling problem

International Union Against Cancer, EU Liaison Office, rue de Pascale 33, 1040 Brussels, Belgium

Luk Joossens  
*consultant*

Department of Public Health Science, Guy's King's and St Thomas's School of Medicine, University of London, London  
Martin Raw  
*honorary senior lecturer*

Correspondence to:  
L. Joossens  
joossens@globalink.org

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substantial in Latin America (about 9%) and Western Europe (about 7%). Western Europe has the highest prices in the world—in 1996 they were four to five times higher than in Africa, the Middle East, and Eastern Europe<sup>4</sup>—yet, despite these high prices, smuggling is on average lower than in other regions of the world. In other words, cigarette smuggling is not caused principally by “market forces.” It is supply driven, caused mainly by fraud through the illegal evasion of taxes.

Yet the tobacco industry has lobbied governments to reduce tobacco tax, arguing that this will solve the smuggling problem and increase government revenues. This is not true: when the Canadian government reduced cigarette tax in response to industry pressure the results were disastrous. Tobacco smuggling not only makes tobacco available cheaply but also sabotages national tobacco taxation and tobacco control strategies. Its key characteristic is not cross border shopping and bootlegging but large scale fraud in which millions of cigarettes evade duty and appear on the contraband market. The true beneficiaries are the tobacco companies.<sup>2</sup> In this article we suggest solutions to combat smuggling which follow logically from a true understanding of its cause.

### Methods

Smuggling is illegal trade, which means that statistics are often not reliable. Customs and excise authorities in various countries do make estimates but often don't

publish them. Apart from figures quoted from published articles, our sources for estimates of smuggled cigarettes have been customs authorities, and for tax revenue tax and health authorities. Often these are based on conversations, exchanges at conferences, or documents unofficially handed to us, but they are rarely "published" or otherwise in the public domain.

## Countries' responses to smuggling

### Canada and Sweden

Canada and Sweden reduced their taxes on tobacco products because of concern about increased smuggling. In Canada the negative consequences for public health and tax revenue are now well documented. After the Canadian tax reductions in 1994 the real price of cigarettes fell by a third. The prevalence of smoking increased in teenagers from 16% to 20% and also increased in the population as a whole.<sup>5</sup> Federal tax revenues fell by \$C1200m, more than twice as much as predicted.<sup>6</sup>

In Sweden the data needed to evaluate the impact of the tax reduction are yet not available. Two substantial tax increases, in December 1996 and August 1997, raised cigarette prices by about 43% to roughly \$6 a pack. They increased tax revenue and reduced cigarette smoking in Sweden.<sup>7</sup> However, in response to the perception that smuggling was becoming a problem (and to lack of public support for the tax increases) the 1997 tax rise was repealed in August 1998.<sup>7</sup> Data on smoking prevalence for 1999 are not yet available, but, as table 1 shows, tax revenue was lower than in the previous two years (Paul Nordgren, National Institute of Public Health, Stockholm, personal communication).

Canada is important for another reason. The key to the story was the export by Canadian manufacturers of Canadian cigarettes to New York State (where there is no market for them as US smokers mainly smoke US brands), from where they were smuggled back into Canada. At the very least, the tobacco industry could be said to have facilitated the smuggling by supplying the cigarettes. In fact, in 1998, for the first time, a tobacco company was convicted for assisting in a smuggling operation. An affiliate of RJR Nabisco pleaded guilty to charges of helping smugglers illegally re-route export cigarettes into Canada. The affiliate, Northern Brands,

agreed to pay US\$15m in criminal fines and forfeitures for its involvement in these illegal activities. In 1999 the Canadian federal government launched a US\$1bn lawsuit in Syracuse, New York, against R J Reynolds companies and the Canadian Tobacco Manufacturers' Council, alleging that the cigarette makers ran a vast illegal smuggling operation. An employee of Northern Brands, to which the cigarettes were exported, pleaded guilty of being in charge of selling eight billion contraband cigarettes into Canada, but RJ Reynolds denies that it played a role in encouraging this.<sup>8,9</sup>

It is clear that more and more governments now feel that the tobacco industry has a case to answer in relation to tobacco smuggling. In recent months Canada, Columbia, and Ecuador have filed lawsuits against US tobacco companies for smuggling. Although the Canadian suit was dismissed in July 2000 on jurisdictional grounds, Canada has now appealed.<sup>10</sup> The European Commission announced in July 2000 that it plans a civil suit against US cigarette makers for alleged involvement in smuggling,<sup>11</sup> and in Britain the Parliamentary Health Select Committee has called for an investigation by the Department of Trade and Industry into the alleged involvement of BAT in smuggling.<sup>12</sup>

### Spain and Andorra

Spain is one of the few countries in the world to have tackled smuggling successfully. It did not do so by reducing tobacco tax. Despite Spanish cigarettes being among the cheapest in the European Union, smuggled cigarettes had a market share of 15% in 1995.<sup>2</sup> One of the sources of smuggled cigarettes in Spain and the European Union was Andorra. In 1997 there was concerted action at national and European levels to reduce the supply of contraband cigarettes. Close collaboration between the authorities in Spain, France, Britain, Ireland, and Andorra and the European Anti Fraud Office (OLAF) reduced the supply of smuggled cigarettes from Andorra. Actions included sealing the Andorran border, civil guard brigades patrolling valleys and hills to make smuggling more difficult, and political pressure on the Andorran government by the European Union and its member states that forced it to create new legislation making it illegal to smuggle tobacco into neighbouring countries.<sup>13</sup>

As a result contraband cigarettes, which had accounted for 12% of the Spanish market in early 1997, held only 5% by mid-1999 (Ignacio Garcia, Customs and Excise, Madrid, personal communication). Sales of legal cigarettes increased from 78 billion in 1997 to 89 billion in 1998, and tax revenue increased by 25% in the same year (Jesus Lauzurica, Customs and Excise, Madrid, personal communication) (see table 2). According to the Spanish customs authorities, their success was not due to controlling distribution at street level, which is almost impossible, but to reducing the supply into the country at "container level" through intelligence, customs activity and cooperation, and technology (Ignacio Garcia, Customs and Excise, Madrid, personal communication).

Andorra is important because it illustrates the role of the tobacco industry. Andorra was not only supplying illegal cigarettes to the Spanish market but also to Britain. Exports from Britain to Andorra (which has a population of only 63 000) increased from 13 million

**Table 1** Swedish tobacco tax revenue (data from National Institute of Public Health, Stockholm)

Year	Revenue (million Kr)
1996	7084
1997	7694
1998	7507
1999	7385

**Table 2** Excise revenue from tobacco sales in Spain (data from Spanish Customs and Excise)

Year	Revenue (billion pesetas)
1996	447
1997	522
1998	653
1999	676

cigarettes in 1993 to 1520 million in 1997. Since few of these cigarettes were legally re-exported and Andorran smokers do not generally smoke British brands, then either each Andorran (including children and non-smokers) was smoking 60 British cigarettes a day in 1997 or these cigarettes were being smuggled out of Andorra. It seems obvious that the companies would know what was happening to their cigarettes. In a television interview on the BBC's *Money Programme* of 8 November 1998, a spokesperson for the tobacco company Gallaher said: "We will sell cigarettes legally to our distributors in various countries. If people, if those distributors subsequently sell those products on to other people who are going to illegally bring them back into this country, that is something outside of our control." In response to the interviewer's comment, "I suggest it is within your control, because you could stop supplying them," the spokesperson said: "That would do nothing to influence the degree of smuggling because the smugglers would just bring back somebody else's product."

### United Kingdom

Tobacco smuggling has become a problem in Britain relatively recently and has been driven by the increased price of cigarettes in Britain compared with the rest of Europe (over £4 or \$6 a packet) and the high value of sterling. As with Canada, smuggling became a problem as mainly domestic brands became available to smuggling networks outside Britain which brought them illegally back into the country. British customs and excise authorities have estimated that the contraband market increased from 3% in 1996-7 to 18% in 1999-2000 and that lost revenue increased from £680m in 1996 to £2500m in 1999.<sup>14</sup>

Again the tobacco industry has argued that this is due to market forces. Again, however, the real problem is not "tourist" cross border shopping and bootlegging but container fraud—that is, the disappearance into the contraband market of container loads of cigarettes exported by the tobacco industry, as illustrated by Andorra. Customs and excise estimate that in 1999 £50m of revenue was lost from smuggling by air passengers, £340m from cross channel bootlegging, but £1400m from container smuggling.<sup>14</sup> This is essentially because a container holds 5-10 million cigarettes, rather than a few thousand, and has a higher profit margin because the cigarettes are exported duty unpaid (rather than duty paid but from a cheaper country). Thus a container of 10 million transit cigarettes (duty not paid) can be bought for \$200 000 and sold for about \$2m, a very attractive profit margin.

The UK government has responded by announcing measures that include a network of scanners for detecting containers, prominent fiscal marks on cigarette packs, increased punishment, more customs officers, and a campaign to increase public awareness. By its own admission, the government hopes to contain rather than eliminate the problem.<sup>14</sup> Given the clear incentive of the tobacco industry to make cigarettes available to smugglers, a real crackdown on smuggling will require controls on cigarette transport, something that will require concerted action at international level.



Customs officers checking a container of contraband cigarettes at the port of Marseille

GERARD JULIEN/AFP

### Conclusions

Andorra shows that tobacco companies view contraband markets as simply one area of market competition. In an extraordinary admission, the deputy chairman of BAT (a former minister for health) recently said: "Where any government is unwilling to act or their efforts are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market."<sup>15</sup> An editorial in the *Guardian* the following day said that this was an incredible admission: "He has openly admitted that the company supplies cigarettes knowing that they are likely to end up on the black market."<sup>16</sup>

A generous conclusion would be that the tobacco industry transports containers of a product worth \$1-3m with astonishing recklessness. In fact, as we have shown, the real problem is fraud, and the real solution must therefore be to control, through international treaty, the transport of this valuable and dangerous product. One of the problems has been that the manufacturers have been technically within the law, arguing that what dealers do with their (legally sold and bought) cigarettes is not their business. Similar arguments have proved socially and politically unacceptable when the product is arms, and so we recommend that tobacco export and transit should be controlled by mechanisms similar to those for arms control. In October 2000 the World Health Organisation will start negotiations for a framework convention on tobacco control. A specific protocol could deal with tobacco smuggling. It could, for instance, require "chain of custody" markings on all packages of tobacco products, placing the onus on the manufacturers to show that cigarettes arrive legally in their end user markets. Manufacturers might also apply for export licences for cigarettes. Only such action at international level will resolve the problem, but it has now been shown to be soluble.

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